Remarks at American Economic Association Panel
Translating Economic Research into Public Policy: Lessons from Economists in Government

Jessica Wachter

January 5, 2025

Thank you Ioana for inviting me to speak at this panel today. Though I am here in my official capacity as the Commission's Chief Economist and Director of the Division of Economic and Risk Analysis, these remarks reflect my own views and do not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

Economics is necessarily the study of real-world problems. Perhaps like many of you, I went into economics because I was interested in understanding the world around me, perhaps with the hope of contributing to human well-being. Years of graduate training and the rigors of journal publication and tenure was not quite enough to drill it out of me. Like others on this panel, I've been very lucky to have an opportunity to serve the American public in an official government role. Specifically, I have served as the Chief Economist for the Securities and Exchange Commission for the past three and a half years. During this time, I was happy to find that the habits of thinking that I learned as a research economist were indispensable to my work in government. Moreover, economic research was and is, crucial to my job and to my agency's mission.

I am going to discuss specific ways in which research economists can contribute to the public policy debate, and therefore to the public good. My remarks reflect my experience at the SEC – a roughly 5000-person agency that is the primary regulator for the United States' $120 trillion capital markets. However, these points may also be applicable to other U.S. government agencies.

From my first phone call with Chair Gensler, I realized how little I knew about the SEC. The SEC is an independent agency, which means it is technically part of the executive branch, but it is also meant to be independent of the President and the Cabinet. The Commission itself consists of five voting members, known as Commissioners – one of whom is the Chair. The President nominates Commissioners who go through Senate confirmation. Commissioners are nominated and confirmed for five-year terms.[1] The President also appoints the Chair from among the Commissioners.[2] No more than three of the Commissioners may be members of the same political party. The usual configuration is for three Commissioners, including the Chair, to be members of the political party in the White House and the other two Commissioners to be from the other party, and that has been the case during most of my time at the SEC. The Chair sets the agenda.[3] The Commission operates by majority vote.

[1] 15 U.S.C. § 78d
[2] Reorganization Plan No. 10 of 1950, 64 Stat. 1265
[3] *Id.*

John Adams said that a republic is a government "of laws, and not of men."[4] Other countries were defined by conquest, but our country was brought into being by a legal document. We think of a corporation as a web of contracts. Our country is the same! Congress writes laws – these are known as statutes – that give the independent agencies their authority. In the case of the SEC, the relevant statutes are primarily the 1933 Securities Act,[5] the 1934 Securities Exchange Act[6] (referred to as the "Exchange Act"), and the 1940 Investment Advisers[7] and Investment Company Acts.[8] Congress can and does amend those acts over time. For example, in 1975 under President Ford, Congress expanded the SEC's authority over equity markets,[9] and, in 1986, under President Reagan, Congress expanded the SEC's authority over Treasury markets.[10] The Dodd-Frank Act also amended these four Acts.[11] When we talk about the 1934 Exchange Act for example, it sounds like we are talking about something old, and we are. However, it is both old and new.

Agencies have broad authorities, but these authorities are not boundless. Shortly after granting authorities in the New Deal, Congress limited them with the 1946 Administrative Procedure Act, the source of the concept of an action being "arbitrary and capricious."[12] A court can vacate an agency action because it is outside the agency's authority, or it can vacate it because it is arbitrary and capricious, among other reasons.[13]

The importance of authority in rulemaking creates a natural role for attorneys in the rulemaking process. The role of economics can seem more subtle, though it is equally if not more significant. For one thing, we have the truth of Keynes's famous quote: "Practical men who believe themselves quite exempt from any intellectual influence, are usually the slaves of some defunct economist."[14] Ultimately, economics aims to tell us about the future outcomes of present policy choices. Votes by the Commission and Court decisions often invoke beliefs about outcomes, even if that belief is as general as "less regulation is better for the economy," or, on the other side, "market participants fail to internalize the costs of their actions." The way I see it, decisions based on an outcome are necessarily

[4] *Thoughts on Government*, John Adams, 1776; Founders' Library, *Thoughts on Government (1776)* (citing John Adams, Thoughts on Government, April 1776) The National Constitution Center, available at https://constitutioncenter.org/the-constitution/historic-document-library/detail/john-adams-thoughts-on-government-1776.

[5] Securities Act of 1933, 15 U.S.C. § 77a *et seq*

[6] Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*

[7] Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq*

[8] Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq*

[9] Securities Acts Amendments of 1975 (Pub. Law 94-29)

[10] Government Securities Act of 1986 (Pub. Law 99-571)

[11] Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. Law 111-203)

[12] 5 U.S.C. § 706

[13] *Id*.

[14] John Maynard Keynes, *The General Theory of Employment, Interest and Money* (1936).

based on economics, even if neither the economics nor in fact the desired outcome is ever made explicit. Ultimately, rules face their test in the real world, where economics governs their fate.

However, waiting for decades for something to work or not is highly inefficient, not to mention imperfect. While economic science itself may be far from perfect,[15] it does allow for one to consider the range of possible outcomes of a regulation in advance. This saves a lot of time and effort! This seems so self-evident, and to be sure there has always been to some extent a role for economics in SEC rulemaking. However, there is no express statutory requirement to conduct an economic analysis.

Rather, I found a fascinating story that spans a century, represented by key phrases in statute brought to life by a body of case law.[16] Broadly speaking, the story of economics in rulemaking is one of one pre-eminent professional class – namely attorneys – remarkably ceding authority to another professional class -- namely economists. I felt that a high level of trust had been placed in me and my division. I didn't want to mess up.

The main statutory language supporting a role for economics comes from three sources. First, there is Section 23(a)(2) of the Exchange Act, added in 1975, which requires that rules not impose an undue burden on competition.[17] Second, in the 1990s, a provision was added to the 1933, 1934, and 1940 Acts that requires the Commission to consider "efficiency, competition, and capital formation" whenever it is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest.[18] Finally, the 1946 Administrative Procedure Act itself requires that an agency action not be "arbitrary and capricious." One way to not be arbitrary and capricious is to examine the economic effects of the action. In the 2000s and 2010s, a series of court cases gave more color to these statements.[19] For example, the D.C. Circuit said that the Commission acted arbitrarily and capriciously for failing adequately to consider a regulatory action's effect upon efficiency, competition, and capital formation.[20] While

[15] Coates, Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications, Yale Law Journal (2015, 124 (4882-2011; Cochrane, John H., "Challenges for Cost-Benefit Analysis of Financial Regulation," The Journal of Legal Studies (2014, 43(S2, S63-S105, available at https://doi.org/10.1086/678351.

[16] For a detailed account, *see* SEC Staff, Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012, *available at* https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[17] More precisely, Section 23(a)(2) of the Exchange Act requires the Commission to consider any impact that the rule has on competition, provides that the Commission shall not adopt any rule or regulation which would impose a burden on competition "not necessary or appropriate in furtherance of the purposes of [the Exchange Act]" and directs it to include in the rule's statement of basis and purpose "the reasons for the Commission's…determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of [the Exchange Act]." 15 U.S.C. § 78w(a(2.

[18] *See* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 106, 110 Stat. 3416, 3424-35; Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 224, 113 Stat. 1338, 1402 (1999.

[19] *See Chamber of Commerce of the U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005; *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010; *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011.

[20] *See Bus. Roundtable*, 647 F.3d 1144.

another case concluded that the Commission had failed to consider a competitive baseline.[21]

Prior to joining the SEC, I familiarized myself with the lively debate on economic analyses that took place in the context of these court decisions and of Dodd-Frank implementation.[22] Scholars and advocates attacked or supported the notion of economic analysis from all sides. An underlying critique was: how could you possibly do cost-benefit analysis in the context of financial regulation? Some of the most significant costs and benefits are difficult if not impossible to quantify.

In the face of this difficulty, the court cases lay out what is expected of us. SEC staff looked to this caselaw as well as other sources including, the economic literature, guidance from other regulatory authorities, and comments and recommendations to develop "the Guidance" that lays out how to conduct an economic analysis for an SEC rulemaking.[23] One aspect of that analysis is that there should be a rationale for the rulemaking. That rationale could be, for instance, a market failure.[24] The Guidance then goes on to describe the elements of the economic analysis, which I will get to in more detail below. I found the Guidance a useful document that has stood the test of time. Though it has no formal legal status, its public nature and its very longevity makes it a touchstone both within and without the SEC during the rule-writing process.[25]

[21] *See Am. Equity*, 613 F.3d 166. In subsequent cases, the D.C. Circuit specifically called out the Economic Analysis as having met the required standard. *See, e.g.*, *Lindeen v. SEC*, 825 F.3d 646 (D.C. Cir. 2016).

[22] Coates, Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications, Yale Law Journal (2015), 124 (4) 882-2011; Cochrane, John H., "Challenges for Cost-Benefit Analysis of Financial Regulation," The Journal of Legal Studies (2014), 43(S2), S63-S105, available at https://doi.org/10.1086/678351; Better Markets, "Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the Securities and Exchange Commission," July 30, 2012, available at http://www.bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf; Kraus, Bruce, and Raso, Connor, "Rational Boundaries for SEC Cost-Benefit Analysis," Yale Journal on Regulation (2013), Vol. 30, available at https://openyls.law.yale.edu/bitstream/handle/20.500.13051/8183/11_30YaleJonReg289_2013_.pdf?sequence=2&isAllowed=y; Cass R. Sunstein, The Cost-Benefit Revolution, 2018, MIT Press, Chapters 1, 7, 8, available at https://direct.mit.edu/books/book/4108/The-Cost-Benefit-Revolution.

[23] Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[24] Traditional market failures include market power, externalities, principal-agent problems (such as economic conflicts of interest), and asymmetric information. *Id.*

[25] Many comment letters explicitly reference the Guidance. A few are "File No. S7-30-22; Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders," SIFMA Asset Management Group Comment Letter, August 13, 2024; "Re: File Numbers S7-21-21 and S7-20-21," Comment Letter of Prof. Craig M. Lewis and Prof. Joshua T. White, Oct. 7, 2022; "Re: Rel. No. 34–93784 (File No. S7–32–10); Rel. No. 34–94062 (File No. S7–02–22); Rel. Nos. IA–5955 (File No. S7–03–22); Rel. Nos. 33–11028; 34–94197; IA–5956; IC–34497 (File No. S7–04–22); Rel. Nos. 33–11030; 34–94211 (File No. S7–06–22); Rel. No. 34-94313 (File No. S7–08–22); Rel. No. 34–94524 (File No. S7–12–22); Rel. Nos. 33–11068; 34–94985; IA–6034; IC–34594 (File No. S7–17–22); Rel. No. IA–6083 (File No. S7–22–22); Rel. No. IA–6176 (File No. S7–25–22); Rel. No. 34-95763 (File No. S7-23-22); Rel. No. 33-11151 (File No. S7-01-23); Rel. No. IA-6240 (File No. S7-04-23),"

The post-Dodd Frank critics who attacked the notion of economic analysis in financial regulation miss, in my view, the most important aspects of economic analysis: Defining the problem to be solved, why the market on its own will not solve the problem, and why the proposed regulatory change would. This evaluation is less likely to be sensitive to specifically precise costs and benefits.

Finally, there is the way this plays out in practice. My role, and the role of my division, is to provide the Commissioners – who vote on the rules – with the best possible information. That includes a full understanding of both the benefits and costs of a rulemaking. The manner in which we provide this information is just as important as the information itself. What I never appreciated before joining the SEC was the level of transparency with which the agency operates in its rulemaking process.

Rulemaking generally starts with a proposal. Under the APA, the Commission typically provides notice of rulemaking, which consists of putting the proposed rules, and the analysis, out for public comment.[26] The economic analysis of the rule proposal is included in the document that the SEC issues to the public. Thus, the public – and any outside economist – can comment on both the substance of the proposed rules and the SEC's reasoning that got us there. If there's a problem with the reasoning, you can tell us about it. Then, the agency must, under the APA and case law, respond to any significant comment when finalizing the rules. This entire record remains public and continues to inform court decisions as well as subsequent rulemaking. This back and forth, in which the Commission's expert staff advise the Commission, the Commission votes on a proposal, the proposal and the reasoning go out for public comment, lots of comments from all perspectives come in, and only then does the Commission finalize the rule, is set forth in the APA itself. It is nothing more nor less than how a free people works through difficult issues and ultimately solves problems.

This structure implies there is an important role for academic economists in this rule-writing process (sometimes called notice-and-comment rulemaking). From money market funds, to equity market structure, to Treasury market structure, to private funds, the comment file and the decision-making process, was enriched by comments from this community. If you are looking to comment on a release, it is useful to know the basic structure: The release consists of three main sections. The first ("front end"), which describes the proposed or final rule, is written by the rule-writing division, generally either the Division of Corporation Finance, the Division of Investment Management, or the Division of Trading and Markets. Then comes the Economic Analysis, written by the

Comment Letter of Managed Funds Association and National Association of Private Fund Managers, July 21, 2023; "Re: Regulation Best Execution, Release No. 34-96496, File No. S7-32-22 (Dec. 14, 2022)," Comment Letter on Behalf of Virtu Financial, Inc., Dec. 14, 2022.

[26] I will use the common shorthand "proposed rules" – though often it is an amendment to an existing rule that is under consideration, not a brand-new rule.

Division of Economic and Risk Analysis, and finally (speaking broadly here), the actual rule text.[27]

The sections of the Economic Analysis generally include a baseline, discussion of the costs and benefits, analysis of efficiency, competition, and capital formation, and finally, the reasonable alternatives. Thus, if you have a different policy in mind from what the Commission is proposing, perhaps that policy alternative is noted in either the questions for public in the front end or the reasonable alternatives in the Economic Analysis. If you send a comment to the Commission, you can then refer to these sections in your comment and note where you agree or disagree with how the agency is thinking about the question. It is not unusual to have an alternative adopted instead of the original proposal. As an economist, I have devoted time and careful attention to thinking about reasonable alternatives at the proposal stage, knowing that they could help set the agency up for a constructive comment process. The money-market fund rulemaking[28] and Regulation NMS[29] are only two of many rulemakings where our adopted rule reflected consideration of alternatives discussed in the proposal.

In constructing a comment letter, it may be helpful to look at other comment letters that have been submitted on the proposal. In some cases, comment letters have responded to each other. Comment letters can number in the thousands for high-profile rulemakings (and in some other cases, of course, there are a mere handful). Imagine writing a paper with thousands of public referee reports, where you could be judged potentially on your response to points raised in any of these. That will give you a sense of the scale of this enterprise. Submitting comments in response to a proposal is one of the most direct ways academic economists, as members of the public, can influence policy.[30]

That's all about the "how." What about the "why?" Input from the academic community, and the public more generally, is crucial because ultimately it helps strengthen the economic analysis. It can help reach the best policy by drilling down to actual points of disagreement, as opposed to atmospherics. It can lead to a consensus position that is better than what any one side would have thought of. Also, as economists we are all too familiar with the notion of policies that are beneficial to the public but where the harms are highly concentrated. This type of regulation receives a lot of attention from industry that

[27] There are other, often shorter typical sections of releases. These include, for example, a discussion of costs of "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995. *See* 44 U.S.C. 3501 *et seq*. They also include a Regulatory Flexibility Act analysis, in which the release considers the impact of a rule on small entities. *See* 5 U.S.C. 601 *et seq*.

[28] Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A Release No. 33-11211 (July 12, 2023) [88 FR 51404 (Aug. 3, 2023)].

[29] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Release No. 34-101070 (Sept. 18, 2024) [89 FR 81620 (Oct. 8, 2024)].

[30] At the end of the comment file is another section that lists "Meetings with SEC officials." It is also possible to request a meeting with the Chair, with Commissioners, or with the staff. At the start of the release are names and contact information.

may have to bear short-term costs. Often the input from affected parties contains helpful information and has an impact on policy. However, economic analysis also has to be the voice of those who are "not in the room" when the decision is being made – that includes both industry and the broader public. Academics who are well-informed on a topic can help represent that voice.

I will close with some long-term thoughts on economic analysis. It would be wonderful to have this community's engagement, at, say a comparable level to the engagement for decision-making at the Federal Reserve. Note that in the 1970s, the Federal Reserve Act, like the Exchange Act, was amended to make explicit a tradeoff that was, perhaps, previously implicit – in this case between price stability and maximum employment. Apparently economic tradeoffs were in style at the time because the amendments to the 1934 Act also contains such a tradeoff: competition and investor protection. Economists of the 1960s and early 70s thought they understood a lot about how the Fed tradeoff worked, but we have learned a few things since then, one of them being the power and limitations of rational expectations. What would such an analysis look like for the 1934 Act tradeoff?

Our capital markets have been a significant source of strength of our economy, but they require continued attention and revision. My own field of asset pricing tends to abstract from institutional structures, and on some level, institutional structures are ephemeral. Our ability, as economists, to look beyond today's institutional structures to market function is vital in assessing the economic consequences of regulation because institutions can and do change. However, some institutions support our legal protections and these are what created our capital markets and keep us strong. These legal protections are what enabled my grandfather to invest, knowing that his name would never be erased from the list of stockholders. They created the broad base of investors that drive capital to its most productive use. I hope that this description is helpful in connecting the academic community, where people know how to think deeply about problems, to the public sector where ideas can be put to practical use.